MVAM

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ASSET MANAGEMENT

MVAM Newsletter

'So What Is Happening?' February 2016

UK Shares Fall 20% Since May

Source: Bloomberg

Equity markets are about expectations. About how the future will turn out. When those expectations change, the markets react. What has happened in the last two months is that expectations of a US led global recovery helped by low oil prices, has turned into fear that the low oil price and other commodity prices are actually damaging the economy.

This has led to sharp falls in markets as the outlook for company profits fall. This has then fed into worries about the hardest hit companies - oil and commodity in particular, going bust. This in turn has hurt the banks who have lent them money. That then triggers fears that the bank bonds held by insurance companies as investments may be wobbly ….and so it goes on. It does make you wonder a little about whether all that regulation of the financial markets over the last ten years has actually missed the point. The house of cards remains it would seem.

After the fall are equities looking cheap now or is there more to come?

As the markets are about expectations, equities trade “cheaply” if the outlook is poor, and trade “expensively” when the outlook is good. Therefore, it does not matter whether they look “cheap” (which they do) or expensive, it is how the outlook is going to change that counts.

So how will the outlook change?

Despite what many think investment is not about crystal balls it is really about looking at indicators and judging the probability of certain outcomes. The factors that are important now (as almost always) are the oil price and interest rates. The factor which is moving the most at any point in time is the most important to markets. In the recent past it has all been about oil. Interest rates have been stuck at the same low level. So the interest rate rise in the US in December was a huge change. It is really the main reason for the recent market turmoil. The market is adjusting to what is called a tightening cycle - a period when rates rise.

Do more rate rises spell more trouble?

Yes and no. This does not mark the end of the equity market as we know it but it seems very similar to the adjustment the markets saw in 1994 when the US started raising rates! While history doesn’t repeat itself it does rhyme and the panic of 1994 feels similar. We got through it……. a 20% fall was followed by a 140% rise.

Are MVAM buying now?

Not just yet. Markets are down over 10% since the start of the year, the Italian market 25%!! We have more cash than usual on the portfolios reducing the exposure to the markets. But we will invest on weak days, in stocks that we see as being “babies thrown out with the bath water”. This may lead to increased dealing as we look to take profits on stocks that then bounce sharply.

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